



# A new protectionism: dashed hopes and perhaps worse for US trade policy

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Over the next 14 months, culminating in US elections in November 2008, the world will learn whether America's budding protectionism reaches full bloom or is just a passing fancy. The global economy can shake off a failed Doha Round of multilateral trade negotiations without missing two beats. But if the United States turns inward as well, the consequences could be profound and far-reaching.

Some would argue that US protectionism is already beyond the budding stage. There has been an explosion in the use of trade remedies in 2007, including the first US antidumping case initiated against Australia in 15 years (involving the electrolytic manganese dioxide industry).

Earlier this year, the United States launched three high-profile complaints against China in the World Trade Organization, and reversed its 23-year-old policy of not applying the countervailing duty (or anti-subsidy) law to so-called non-market economies, when it initiated a case against Chinese paper manufacturers in April. And there has been a lot of sabre-rattling in Congress over a host of allegedly unfair Chinese trade practices.

But, by and large, the United States has yet to cross the precipice. Bringing

antidumping and countervailing duty cases and launching WTO complaints are all permitted within the global trade rules. Those actions are not necessarily cause for alarm—at least relative to what could be in store in the months ahead.

The Democratic Party, which has grown increasingly hostile towards trade over the past decade, controls the legislature, and thus the policy agenda, for the first time in 12 years.

President George W. Bush's authority to negotiate trade agreements and present them to Congress for an up-or-down vote (the so-called Fast Track or Trade Promotion Authority) expired in June, and will not be renewed. Completed bilateral trade agreements with South Korea, Colombia, Peru and Panama have been shunted aside to consider, instead, trade legislation that is antagonistic, if not expressly protectionist. Although a few of those bills were crafted mostly for political effect, it is a good bet that some of the nearly two dozen pieces of provocative trade legislation will at least make it to the floors of both chambers of Congress for official votes before the 2008 elections.

As Congress reconvenes in Washington, it is likely to begin moving some of those bills, which include, among other things, provisions that:

- make enforcement of trade agreements systematic and mandatory;
- lower the current evidentiary thresholds for imposing antidumping, anti-subsidy, and China-specific safeguard duties;
- establish a panel of retired federal judges to review adverse WTO decisions and advise Congress on the propriety of those decisions before any steps toward compliance are undertaken;
- forbid the United States from entering into any new trade agreements;
- revoke China's 'normal trade relations' status;
- define and treat currency manipulation as a countervailable subsidy;
- require the President to pursue concrete measures to achieve greater trade balance with countries that have persistent trade surpluses with the United States; and,
- expand trade adjustment assistance programmes to cover people who have lost jobs in the services sectors due to outsourcing.

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# To the mercantilists in Congress, the large and growing trade deficit is confirmation that the United States is losing at trade. And it is losing because US trade partners are cheating.

Implicit in this legislation: trade liberalisation is bad, US trade partners cheat, and the folly of America's embrace of globalisation is evidenced by its massive human toll.

The primary target of most provocative legislation is China. But that shouldn't prompt sighs of relief in other countries. Thwarting Chinese imports into the United States is an indirect assault on other countries, particularly those in the Asia-Pacific region. What the US Congress fails to grasp is that many products imported from China comprise value-added materials and labour services provided mostly in other countries. In that regard, the bilateral US trade deficit with China is a meaningless statistic. Yet it fuels the legislative push for action.

Adoption of the kinds of protectionist policies under consideration in the United States would likely have a dramatic, adverse impact on the global economy, with particularly acute consequences felt in countries that supply China with components, machinery, and raw materials. If the world's largest consuming nation buys fewer Chinese wares, Chinese factories won't be buying as much iron ore, bauxite, electronic components, or LCD screens. There is indeed a bit of Australia, Japan, Korea, and Malaysia in the typical Chinese cargo container unloaded in Long Beach, California.

Furthermore, legislation that effectively challenges the efficacy and legitimacy of the WTO dispute settlement system can only lead to a weakening of the multilateral trading system, as other countries are tempted to follow suit and treat adherence to the rules as optional. Ironically, the Congress is seeking to beef up US enforcement and prosecutorial capacity to bring more WTO cases, while it simultaneously considers a bill that denigrates the WTO process, as well as other bills containing provisions likely to be WTO-inconsistent.

The WTO system isn't perfect, but it has worked well to facilitate the growth of trade and investment, while practically extinguishing the his-

toric tendency towards tit-for-tat trade wars. Until now, at least.

Once-giddy expectations for comprehensive international trade liberalisation at the outset of the Bush Administration have been downgraded to hoping that the US President is prepared to veto the slew of anti-trade legislation expected to reach his desk. Not too long ago, Bush Administration officials spoke optimistically about a free trade zone 'from Alaska to Tierra del Fuego', and a world free of industrial tariffs by 2015. The Administration initiated bilateral trade talks with dozens of countries as part of its programme of 'competitive liberalisation', hoping that the momentum that it spurred would lead to a relatively quick and successful conclusion to the Doha Round.

But Doha lies in a cryogenic state and it remains to be seen whether the Bush Administration is able—even willing—to hold the line against the impending protectionist offensive. Some in Congress speak of veto-proof majorities (Congress can override a Presidential veto with support from two-thirds of each chamber), which attests to the growing bipartisan nature of skepticism over trade.

Not long ago, Republicans were solidly in the pro-trade camp, while Democrats abandoned the pro-union, anti-trade line with infrequency and at their individual peril. As we enter the spirited US election season, President Bush is likely to be pressured by Republican lawmakers and the party leadership to acquiesce before the rising protectionist tide in an effort to minimise Republican losses in November 2008.

The era of negotiation and accommodation and optimism has yielded to one of confrontation and litigation and skepticism.

It is difficult to pinpoint a specific event that precipitated America's apparent change of heart. It has been more of a drift, perpetuated by a confluence of several factors, including the rise of China, the myth of US manufacturing decline, relentless salesmanship from politicians and media personalities of their mercantilist narratives, widespread disaffection for President Bush and, also, the failure of the Bush Administration to make a convincing, comprehensive case to the American public about the benefits of trade liberalisation.

That last factor is probably the most significant determinant of the present state of affairs. Had the Administration done a better job of communicating the merits of a liberal trade agenda through its words and actions, the other factors might never have risen to prominence.

But instead, the Bush team opted to politicise the process. They reckoned that with a Republican majority in Congress at the time, the trade agenda could advance without need of much Democratic support. Given the anti-trade sentiments permeating the Democratic caucus, that strategy had virtue, if not merit.

Ultimately, though, that approach alienated important Democrats who now control the congressional trade agenda. And it would be naïve to think that experience doesn't colour their current perspectives on trade policy.

Bush granted steel tariffs to make it easier for certain Republicans in Congress to support trade promotion authority—a move characterised by former US Trade Representative Robert Zoellick as 'one step back for two steps forward'. Similar protectionist back-steps were taken to secure support from key Republicans in textile- and farm-states, as well. In that process, the Administration legitimised the claims to exceptional treatment for import-competing industries while preaching the merits of free trade abroad, a hypocrisy that contributed to the poisoned atmosphere surrounding the Doha Round.

The Administration also erred badly in the way it promoted trade agreements. The USTR's office has had a short-sighted tendency to focus on the benefits of trade from an exporter's perspective. A common refrain from the USTR when pitching trade liberalisation is that the United States runs an aggregate trade surplus with the dozen or so countries with which the Administration had concluded bilateral or regional trade agreements—the implication being that strong export growth and minimal import growth constitutes success. But if that's the appropriate metric, it doesn't take much of a leap to conclude that US trade policy is failing given an overall trade deficit approaching \$1 trillion.

That kind of salesmanship—touting exports and downplaying the benefits of imports, which are the source of most of the gains from trade—played into the hands of the mercantilists in Congress, where too many already believe that exports are good, imports are bad, and the trade account is the scoreboard. To them, the large and growing trade deficit is confirmation that the United States is losing at trade. And it is losing, in large measure, because US trade partners are cheating.

In China's case, the purported transgressions include currency manipulation, widespread subsidisation of industry, unfair labour practices, intellectual property theft, opaque market barriers, among others. Some of the allegations have some degree of merit, but not to an extent that comes close to explaining even a fraction of the bilateral deficit.

Allegations of currency manipulation and its adverse impact on the US manufacturing sector have dominated the political discourse this year. As Congress gripes and threatens action, the Chinese Yuan continues to appreciate against the US dollar. It is up nearly 8 per cent since the firm dollar peg was abandoned in July 2005. Yet the bilateral deficit continues to rise. It is quite clear that Congress hasn't given much thought to the prospect that a dramatically appreciated Yuan could actually increase the deficit.

The key to achieving greater trade balance without sparking a US recession is not to tax US consumption through protectionist legislation, but to encourage Chinese consumption. That is the essence of what has become known in Washington as the 'Paulson Approach'. Treasury Secretary Henry Paulson has been engaged in dialogue with his Chinese counterparts, trying to foster the kinds of structural changes needed to dissuade excessive thrift there. However,

Congress seeks fireworks, not durable solutions.

But why focus on the trade balance at all? Japan has run a trade surplus for decades, but its economy has been stagnant for the better part of the last 15 years. The Germans have a large trade surplus, but double-digit unemployment. The United States has a large and growing trade deficit, but also consistently strong economic growth and an unemployment rate, near all-time lows, of 4.5 per cent.

Still, the trade account as scoreboard metaphor resonates. Americans are told repeatedly that their jobs are being exported to China and India and that the trade deficit is a proxy for job loss. The loss of nearly 3 million US manufacturing jobs during the recession of 2001–2002 is constantly cited as evidence of failed trade policies, even though the US economy has generated 1.8 million net new jobs every year, on average, since 1980, when imports, in real terms, were only 45 per cent of what they are today.

Policymakers have perpetuated a myth that the US manufacturing sector is in decline, which has encouraged further skepticism among Americans about trade. But closer examination reveals not only that US manufacturing is thriving according to every relevant financial yardstick (in 2006, the sector achieved record sales, record profits, record output, and record return on investment), but that it is thriving in large measure because of relatively open US trade policies.

Access to foreign markets has been a crucial component of US manufacturing revenue growth. And access to imported raw materials, components, and capital equipment has helped keep the lid on US manufacturers' costs. In fact, US producers accounted for 55 per cent of total US imports in 2006, which affirms a long-observed relationship in the manufacturing sector: imports and output move in tandem.

It is unlikely that the truth about trade and manufacturing will suddenly prevail upon the political discourse and reverse America's growing skepticism. Not with an election on the horizon. Perhaps the best to hope for is that some of the pending legislation is made less onerous as it advances through the process, while President Bush does his part to veto legislation that would take the United States, and the world, down a path it would regret.

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